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No. 88-489

In the Supreme Court of the United States

OCTOBER TERM, 1988

DWIGHT A. MCKABNEY AND MERCEDES P. MCKABNEY,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioners seek review of the decision of the court of appeals (Pet. App. 1a-2a) dismissing their claim that Mr. McKabney's salary from the Panama Canal Commission is exempted from United States taxation under Article XV(2) of the Agreement in Implementation of Article III of the Panama Canal Treaty, Sept. 7, 1977, T.I.A.S. No. 10031.[1]

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[1] Article XV(2) of the Agreement in Implementation of Article III of the Panama Canal Treaty, Sept. 7, 1977, provides:

> 2. United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payment of taxes, fees, or other charges on income derived from sources outside the Republic of Panama.

1. a. In January 1986, petitioners sued in the U.S. Claims Court to recover federal taxes withheld from wages earned by Mr. McKabney from 1979 to 1981 as a civilian employee of the Panama Canal Commission,[2] contending that the pertinent provision of the Panama Canal Treaty Implementation Agreement, Article XV, exempted that income from United States taxation (Pet. 5).

b. Petitioners' suit was suspended pending this Court's review of consolidated cases (Pet. 6 n.2), including the Federal Circuit's decision in *Coplin* v. *United States*, 761 F.2d 688 (1985), that raised the issue of exemption of income earned in Panama from United States taxation. In its decision, *O'Connor* v. *United States*, 479 U.S. 27 (1986), this Court unanimously affirmed the judgment of the Federal Circuit in *Coplin* and ruled that Article XV(2) of the Implementation Agreement was not intended to restrict the right of the United States to tax citizens employed by the Commission.

c. The Claims Court thereafter dismissed petitioners' suit (Pet. App. 3a, 4a), and the Federal Circuit affirmed (*id.* at 1a-2a), holding petitioners' claim foreclosed by this Court's decision in *O'Connor* (*id.* at 1a). The court of appeals rejected petitioners' contention that the Claims Court should have conducted an evidentiary hearing to consider allegedly "new evidence" bearing on the correctness of the *O'Connor* holding. The court stated that "the Supreme Court had much of this allegedly new evidence before it when it decided *O'Connor* [, and] apparently it found that evidence unpersuasive" (*id.* at 2a). In any event, the court observed, "treaty interpretation is a question of law and not a matter of fact" (*ibid.* (citations and

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[2] Mercedes McKabney is a party in this suit because she filed a joint tax return with her husband.

~~and~~ internal quotations omitted)), and the court was bound to apply this Court's "unequivocal" interpretation in *O'Connor* of Article XV(2) of the Implementation Agreement (*ibid.*).

2. Petitioners' challenge was foreclosed by the decision in *O'Connor* v. *United States*, 479 U.S. 27 (1986), and, therefore, was properly dismissed. There is no basis for further review by this Court.

a. In *O'Connor*, this Court held that Article XV(2) of the Implementation Agreement did not exempt salaries earned by American employees of the Panama Canal Commission from United States taxation. The Court examined the plain language of the treaty as well as the actions of both the United States and the Republic of Panama in applying the Treaty's terms. See *O'Connor* v. *United States*, 479 U.S. at 33 (citing *Trans World Airlines, Inc.* v. *Franklin Mint Corp.*, 466 U.S. 243, 259-260 (1984)). The Court determined that the text, consistent with the "overwhelmingly convincing" verbal context of Article XV(2), provided an exemption only from Panamanian taxes (479 U.S. at 31).

Petitioners asked the appeals court to override this Court's interpretation of the Treaty in *O'Connor* on the basis of "new" evidence that, they maintained, warranted a different outcome. The Federal Circuit recognized that, contrary to petitioners' assertion (Pet. 7-9), treaty interpretation is a question of law (*Strong* v. *United States*, 518 F.2d 556, 563 (Cl. Ct.), cert. denied, 423 U.S. 1015 (1975); *United States ex rel Chunie* v. *Ringrose*, 788 F.2d 638, 643 n.2 (9th Cir.), cert. denied, 479 U.S. 1009 (1986)) and that petitioners were, in effect, urging the court to reconsider the legal issue settled by this Court in *O'Connor*. As the Claims Court correctly understood in *Bonanno* v. *United States*, 12 Ct. Cl. 769, 771 (1987), "[i]t is axiomatic that [a lower court] cannot disregard the Supreme Court's legal

decisions even if it is persuaded that the Supreme Court was in error" (Pet. App. 8a (citations omitted)). Accordingly, the appeals court correctly affirmed the dismissal of petitioners' claim.

b. Petitioners argue (Pet. 11-12) that the government's fraudulent conduct throughout the course of the *O'Connor* litigation justified reconsideration of the exemption issue decided in that case. They contend that the government's "nonproduction" of a 1975 draft of Article XVI of the Agreement in Implementation of Article IV of the Panama Canal Treaty[3] was "material" and "inexcusable" (Pet. 13) because the change in language from the 1975 draft to the final version of Article XVI(2) indirectly shows that the final version of Article XV was intended to create an exemption from United States as well as Panamanian taxation (Pet. 14).

Because the 1975 draft of Article XVI had no apparent relevance to the issue in *O'Connor*, which dealt with Article XV—and not Article XVI—of the Agreement, there was no reason for the government to produce it during the *O'Connor-Coplin* litigation. Hence, there was no fraudulent concealment.

Indeed, petitioners' strained suggestion that bilaterality of the exemption in Article XV(2) can be inferred from the evolution of Article XVI(2) rests on a false premise. Their entire argument depends on the erroneous assumption

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[3] The 1975 draft reads as follows (Pet. 12-13):

> (2) Members of the forces or the civilian component, and dependents, shall be exempt from taxes, assessments, or other charges to the Republic of Panama or any entity or political subdivision thereof * * *

Petitioners compare that provision with the final text of Article XVI(2) as it appeared in the treaty agreement in 1977 (Pet. 13):

> (2) Members of the Forces or the Civilian component, and dependents, shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the United States Armed Forces. * * *

that, by replacing the 1975 language in Article XVI(2) that spoke of an exemption "from taxes * * * to the Republic of Panama" with the phrase "any taxes," the drafters expanded the unilateral exemption to a bilateral exemption. However, the final version of Article XVI(2) unquestionably permits United States taxation of armed forces personnel salaries, and creates a unilateral exemption from Panamanian taxation only. Indeed, in the course of arguing that differences in the phraseology of the two articles demonstrated that Article XV(2), unlike Article XVI(2), created a bilateral exemption, the taxpayers in the *O'Connor-Coplin* cases acknowledged that Article XVI(2) does not exempt members of the armed forces from United States taxation. See *O'Connor* v. *United States*, 479 U.S. at 34. The Court rejected petitioners' argument as to Article XV(2), but, in so doing, tacitly accepted their characterization of the final version of Article XVI(2) as creating only a unilateral exemption (*ibid.*).[4]

The Court in *O'Connor* also pointed out that "the structure of Article XV is similar to that of Article XVI," in that the reference in the first section of Article XV to the "*payment in the Republic of Panama* of all taxes," like a similar reference in Article XVI(1) to regulations *of the Republic of Panama*, "establishes the context for the discussion of tax exemptions in the entire article" (479 U.S. at 30 (emphasis added)). Since the reference in the first section of Article XVI "establishes the context" for the second section of that Article, the deletion of the explicit reference to the Republic of Panama from the earlier draft of Article XVI(2) simply eliminated a redundancy.

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[4] The Claims Court in *Coplin* v. *United States*, 6 Cl. Ct. 115, 137 (1984), and in *Bonanno* v. *United States*, 12 Cl. Ct. 769, 773 (1987), also concluded that Article XVI(2) provided no exemption from United States taxation.

In sum, petitioners' claim that the 1975 draft illuminates the meaning of Article XV(2) is meritless, since it depends on the premise that the final version of Article XVI(2) represented a shift from a unilateral to a bilateral exemption—a premise that is entirely unsupported and contravenes the settled interpretation of that provision.

c. Petitioners also contend (Pet. 14) that a "due-process [*sic*] issue arises out of other aspects of the government's conduct" in the *O'Connor-Coplin* litigation. First, petitioners question the authenticity of the Panamanian diplomatic note, delivered to the United States prior to argument in the Federal Circuit in *Coplin*, which stated Panama's position that the relevant articles of the treaty provided an exemption only from Panamanian taxes. Petitioners contend that remarks made in July of 1984 by a member of the Panamanian negotiating board, Dr. Cardoze (Pet. App. 18a), undermine the note's validity, and that the transcript of those remarks was not produced by the government nor introduced in *Coplin*.

This line of argument is entirely without foundation. Both the diplomatic note (see *O'Connor* v. *United States*, 479 U.S. at 33 n.2) and the transcript of the Cardoze remarks (see Brief for Petitioners at 39-42 in *O'Connor* v. *United States, supra*) were part of the record in the *O'Connor* litigation, and neither the Federal Circuit nor this Court found the material helpful to petitioners' position. Thus petitioners do not present "new" evidence that would justify revisiting the question decided in *O'Connor*. In all events, as petitioners acknowledge (Pet. 15), the Court in *O'Connor* found no need to consider the diplomatic note (479 U.S. at 33 n.2), and thus did not rely on it. For this reason, any evidence bearing on its validity provides no occasion to question the Court's controlling decision in that case.

Petitioners also erroneously characterize as "new evidence" (Pet. App. 25a) an affidavit of Dr. Aristides

Rojo that was submitted to the Court, in advance of argument, by the petitioners in the *O'Connor* case (see Gov't C.A. Br. App. C). Although available to this Court, it merited no mention in the *O'Connor* opinion and certainly provides no basis for reconsideration in this case of this Court's holding in *O'Connor*.[5]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

CHARLES FRIED
Solicitor General

NOVEMBER 1988

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[5] We finally note that the question presented here is not of continuing importance because Section 1232(a) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2563-2564, provides, in relevant part, that for "all taxable years whether beginning before, on, or after the date of the enactment of this Act," no provision of the Panama Canal Treaty or its Implementation Agreements "shall be construed as exempting (in whole or in part) any citizen or resident of the United States from any tax under the Internal Revenue Code of 1954 or 1986." This Court found it unnecessary to address this legislation in *O'Connor*, 479 U.S. at 30 n.1.

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